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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1934.

Nos. 479-490.

In The Matter of
THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY CO., *Debtor.*

Nos. 479 and 480
CONTINENTAL ILLINOIS NATIONAL BANK & TRUST COMPANY, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 481 and 482
THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 483 and 484
MISSISSIPPI VALLEY TRUST COMPANY, *Petitioner, v.* THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 485 and 486
HARRIS TRUST & SAVINGS BANK, *Petitioner, v.* THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 487 and 488
THE NEW YORK TRUST COMPANY, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

Nos. 489 and 490
RECONSTRUCTION FINANCE CORPORATION, *Petitioner,* v. THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY, ET AL., *Respondents.*

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF OF RESPONDENT, PROTECTIVE COMMITTEE FOR THE CHICAGO, ROCK ISLAND & PACIFIC RAILWAY COMPANY GENERAL MORTGAGE BONDS

Opinions Below

No opinion was rendered by the District Court. The opinion of the Circuit Court of Appeals (R. 313-326) is reported in 72 Fed. (2nd) 443.

Jurisdiction

The jurisdiction of this Court rests upon Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, pursuant to which writs of certiorari were granted on December 3, 1934.

Question Presented

The question presented is whether a Court having jurisdiction under Section 77 of the Bankruptcy Law of the estates of a Railroad Corporation Debtor and several Subsidiary Debtors may control attempts by a secured creditor of the Debtor to transfer after the commencement of the proceeding mortgage bonds of the Principal Debtor and mortgage bonds of the Subsidiary Debtors which are held to secure the creditor's single claim, if the effect of such transfers would be to alter the classes of "creditors," as defined in Section 77, and to change the framework on which a plan of reorganization would have to be based.

Statement of the Case.

1. The Debtors in the Proceeding:

On June 7, 1933, The Chicago, Rock Island & Pacific Railway Company filed a petition under Section 77 of the Bankruptcy Law, thus commencing this proceeding. It is hereinafter referred to as the "Principal Debtor."

Subsequently various subsidiaries of the Principal Debtor filed similar petitions, as provided by subdivision (a) of Section 77 (Appendix to R. F. C. Brief, p. 91), and thus became debtors *in the same proceeding*. They included (R. 23-28, 92-100): St. Paul and Kansas City Short Line R. R.

Co., Rock Island, Arkansas and Louisiana R. R. Co., Chicago, Rock Island & Gulf Railway Co., Rock Island and Dardanelle Railway Co., Rock Island Memphis Terminal Railway Co., and Rock Island Omaha Terminal Railway Co. These six companies are hereinafter referred to as the "Subsidiary Debtors."

The fact that these Subsidiary Debtors are Debtors *in this same proceeding* is of the greatest importance, for the "collateral" affected by the order under review consisted principally of mortgage bonds issued by the Principal Debtor or by the Subsidiary Debtors, and represented fractional interests in liens on property in the several estates under the jurisdiction of the Court.

The Petitioners' Briefs refer to these Subsidiary Debtors as if they were merely subsidiaries of the Debtor, and as if there were only one Debtor. But they are Debtors in this same proceeding.

The several estates are being administered in only one proceeding (R. 26-28, 97-99), as Section 77 clearly intended they should be (Appendix to R. F. C. Brief, p. 91). Any order made in the proceeding can, therefore, properly affect the several estates. And, to the extent that the order under review related to interests in property in the estate of a Subsidiary Debtor, it affected property which was just as clearly under the jurisdiction of the Court as the property in the estate of the Principal Debtor.

2. The Other Parties to the Proceeding:

The Petitioners and the Trustees of the Principal Debtor will have set forth their own status in the proceeding.

The two Committees which filed pleadings or affidavits in connection with the order appealed from are the General

Mortgage Committee and the First and Refunding Committee.

The Protective Committee for The Chicago, Rock Island & Pacific Railway Company General Mortgage 4% Bonds of 1988, represents the holders of the Principal Debtor's General Mortgage Bonds (R. 32-33). The General Mortgage, which was executed on January 1, 1908 and matures on January 1, 1988, provided for the issuance of $100,000,000 of Bonds, of which $99,981,000 have been actually issued (R. 33, 59). Of this amount, $61,581,000 are outstanding in the hands of the public, and $38,400,000 are pledged to secure the Principal Debtor's First and Refunding Mortgage (R. 33, 59).

The General Mortgage is a first lien on more than 3,000 miles of railway (R. 33, 60), "principally main lines, on which the traffic is heaviest and which are among the most valuable lines of the Debtor" (R. 60). The interests of the holders of the General Mortgage Bonds are, therefore, those of *holders of a main line first mortgage.*

The General Mortgage Committee is interested in sustaining the order under review for two reasons:

First, because such an order seems essential if a plan of reorganization is to be formulated;

Second, because the order was to some extent occasioned by the effort of the pledgees to force the payment of interest on their claims, although the interest had not been earned and the payment of the interest required the diversion of General Mortgage earnings for that purpose.

3. The Position of the General Mortgage Committee as Compared With the Position of the Other Respondents:

The position of the General Mortgage Committee is that the order under review is plainly right as to substantially all

of the collateral affected thereby and that it is right as to such collateral *because of the nature of the collateral.*

The grounds on which this position is based may differ to some extent, or even substantially, from those urged by other Respondents. It is only fair to them to point out that the General Mortgage Committee represents holders of underlying mortgage bonds and is not necessarily disposed to accept as "liberal" a construction (R. 323) of Section 77 as the representatives of junior interests may think proper.

The General Mortgage Committee considers it unnecessary to determine how "liberally" Section 77 should be construed. The Committee believes that, so far as this case is concerned, the effect of Section 77 is clear, whether it be "liberally" construed or not.

And we shall make no effort to discuss many of the subjects referred to in the Briefs of the Petitioners, particularly that of the Reconstruction Finance Corporation (pp. 70-89). Pledgees, like mortgage bondholders, have valuable contracts, and prior to bankruptcy have valuable remedies. Bankruptcy affects their remedies. To what extent their remedies are affected by bankruptcy is a question of law as to which the statutes and interpretations thereof are controlling. It is a matter of importance that the law be clearly established on the questions here presented. But we are unable to apprehend why a different rule of law should be established for Reconstruction Finance Corporation because of its charter powers (R. F. C. Brief, pp. 65-70), or how any question of economic policy is presented (*id.*, pp. 70-89).

4. The Necessity for the Order Below; the Relation Thereto of the Pledgees' Demands for Interest:

The necessity for the order under review arose because of the effect of any transfer of the collateral by the pledgees, if recognized as having any validity, on the possibility of formulating a plan of reorganization and carrying it through the many stages required by Section 77 of the Bankruptcy Act (see below, pp. 14-37).

This necessity existed whether interest was paid on the pledgees' claims or not. But it is clear that the demand of the pledgees that interest be paid on their claims, whether earned by their collateral or not, was a factor in inducing the other parties in interest to obtain the order below (R. 14, 20, 29, 40, 42, 76-77). For the latter were satisfied that if interest were paid on the pledgees' claims they would not transfer the collateral, whereas, if it were not, they might (R. 14, 20, 29).

It is equally clear that, in order to make the most of the situation (R. 76-77) and to induce further interest payments, the pledgees took the most extreme possible position when the Debtor's petition for the injunction order was filed (R. 68-75). Instead of suggesting terms and conditions on which transfers might have been permitted, they challenged the jurisdiction of the Court and its power to act in the matter at all (*id.*). Now, however, they protest that the order was arbitrary, because it contains no limitations of time or other conditions, although they suggested none.

The position of the General Mortgage Committee is that interest should never have been paid to the pledgees at all (R. 32-35, 59-63), and if the statement of the Circuit Court of Appeals on the subject (R. 325) is to be construed as implying that interest was properly paid and should be continued, it was erroneous. Because the matter is one

which concerns the General Mortgage bondholders materially, we are including a statement about it, so that the record for this Court will be clear and readily available (see below, pp. 53-55).

But it is plain that the matter of the interest on the pledgees' claims, and any misunderstanding of the Circuit Court of Appeals on the subject (if there was one), has nothing to do with the question of the power of the Court to make the order under review. And, as will appear below, only that question is involved here.

5. The Order Under Review and the Record on Which It Was Made:

The order under review restrained the pledgees from "selling" their "collateral" (R. 101-104).

As will appear below, the collateral consisted almost entirely of interests in the several estates which the Court was administering.

Much is now said of supposed deficiencies in the petition and other papers on which the order was made (Brief for R. F. C., pp. 21-32). But the same Petitioner prints an Appendix containing considerable data not in the record, and refers to New York Stock Exchange Quotations (pp. 10-11) and many other things not in the record or in the Appendix to its Brief.

We take it that this Court can examine the entire record to ascertain the facts, which are not substantially controverted.

6. The Pledgees' Collateral:

The pledgees' claims total $17,784,877. The face amount of their collateral is $54,711,465 (R. 36-39).

The nature of the pledgees' collateral is, we think, the crucial factor in this case. It is listed in the Principal

Debtor's petition on which the order under review was entered (R. 37-39). It falls into four classes:

First: Mortgage Bonds issued by the Principal Debtor, which are a lien on property of the Principal Debtor, and which, if owned outright, would constitute obligations of the Principal Debtor.

The bonds falling in this class are The Chicago, Rock Island & Pacific Railway Company First and Refunding 4% Bonds (R. 4), which were pledged as follows (R. 36-39):

Reconstruction Finance Corporation	$7,575,000
Chase National Bank	3,253,000
Continental Illinois Bank & Trust Co.	1,307,000
New York Trust Company	800,000
Harris Trust and Savings Bank	405,000
Mississippi Valley Trust Company	190,000
	$13,530,000

Second: Mortgage Bonds issued by a Subsidiary Debtor, but Guaranteed by the Principal Debtor. They are a lien on property of the Subsidiary Debtor, which is operated under lease by the Principal Debtor. If owned outright, they would constitute obligations of both the Principal Debtor and the Subsidiary Debtor.

The bonds in this class include the St. Paul & Kansas City Short Line First Mortgage Bonds and the Rock Island, Arkansas and Louisiana Railroad Company First Mortgage Bonds.

Each of these corporations is a wholly owned subsidiary of the Principal Debtor (R. 23); all of the properties of each are operated by the Principal Debtor under leases for 99 years and 999 years respectively (R. 23); the Bonds of the two subsidiaries are guaranteed by the Principal Debtor (R. 4, 29, 20-21, 31); and the two Subsidiary Debtors are Debtors in this same proceeding (R. 23-28).

The St. Paul & Kansas City Short Line First Mortgage Bonds are pledged as follows (R. 37-39):

Reconstruction Finance Corporation	$9,374,500
Chase National Bank	3,956,000
Continental Illinois Bank & Trust Co.	2,758,000
New York Trust Company	1,010,000
Harris Trust and Savings Bank	490,000
Mississippi Valley Trust Company	240,000
	$17,828,500

Rock Island, Arkansas and Louisiana First Mortgage Bonds are pledged as follows (R. 37):

Reconstruction Finance Corporation	$3,862,000

All of the collateral held by the Banks falls in the two foregoing classes.

Third: Bonds issued by a wholly owned Subsidiary Debtor, but which are not guaranteed by the Principal Debtor.

This class includes the following bonds pledged to Reconstruction Finance Corporation (R. 38, 92-99):

The Chicago, Rock Island & Gulf Railway Co. Extension First Mortgage Bonds	$6,927,000
The Chicago, Rock Island & Gulf Railway Co. Carrollton Branch Bonds	331,000
Rock Island and Dardenelle Railway Company First Mortgage Bonds	100,000
Rock Island Memphis Terminal Depot First Mortgage Bonds	900,000
Rock Island Memphis Terminal First Mortgage Bonds	400,000
Rock Island Omaha Terminal First Mortgage Bonds	906,000
	$9,564,000

Of the four Subsidiary Debtors which issued these bonds, all except The Chicago, Rock Island and Gulf Railway Company are operated under lease by the Principal Debtor (R. 92-94).

Fourth: Other Collateral.

The remaining collateral, all of which is pledged to the Reconstruction Finance Corporation, was as follows (R. 38):

Kankakee & Seneca Railroad Company 4½% Bonds	$352,000.00
Rock Island Improvement Company:	
Blue Island Shops Bonds	199,000.00
Cedar Rapids Terminal Bonds	369,732.99
Little Rock Mortgage Bonds	278,492.49
Peoria Terminal Mortgage Bonds	290,247.86
First and Collateral 5% Bonds	3,310,000.00
Trinity & Brazos Valley Receiver's Certificates	747,492.51
Trinity & Brazos Valley First Mortgage Bonds (now pledged under Colorado & Southern Mortgage; C. R. I. & P. has agreed to pledge them with Reconstruction Finance Corporation upon release from that Mortgage May 1, 1935)	4,380,000.00
	$9,926,965.85
Assignment of Company's distributive share in assets of Railroad Credit Corporation, approximately	$1,400,000.00

With respect to the mortgage bonds falling in this class of collateral, the petition on which the order under review was entered alleged that the bonds were "First Mortgage Bonds of subsidiary companies of the Debtor's System" (R. 38). This allegation is uncontroverted. The Appendix to

the Reconstruction Finance Corporation Brief contains the following from the Interstate Commerce Commission Report approving the loan with regard to the Rock Island Improvement Company Bonds (p. 37; see also pp. 38-39, 73-74):

> "The applicant states that all of the aforesaid collateral consists of first-mortgage bonds representing the only existing liens upon railroad and terminal properties in important cities used by and in the interest of the applicant and essential to the operation of its railroad system."

Summary of the Argument.

I. This case does not involve the right of pledgees to sell ordinary collateral.

II. The pledged Chicago, Rock Island & Pacific Railway Company First and Refunding Bonds do not represent debts of the Principal Debtor, but merely fractional interests, held as security only, in property which is part of the Principal Debtor's estate.

III. As a result of the commencement of the proceeding under Section 77 of the Bankruptcy Law, each pledgee is simply a secured creditor of the Principal Debtor, holding a single claim. Transfers of the pledged First and Refunding Bonds, if recognized, would be merely transfers of ratable shares of the lien of the mortgage. No pledgee has any power to transform the pledged bonds into debts by transferring them to someone else.

IV. Section 77 of the Bankruptcy Act contemplates action by the various classes of creditors, and presupposes that the classes shall be fixed as of the commencement of the proceeding. The transfer of the pledged First and Re-

funding bonds, if recognized in the bankruptcy court, would create a new class of "creditors" as defined in Section 77.

The formulation of a plan of reorganization would be impossible if transfers of the bonds were to be permitted without control and recognized, because it would be impossible to know what classes to provide for and what claims.

V. The assignment after bankruptcy of claims against or interests in a bankrupt estate is not a matter of constitutional right, and such assignments are subject to such control as may be authorized by statute.

VI. Even if we are wrong in assuming that transferees of the pledged First and Refunding Bonds could not prove claims for the face amount thereof (as distinguished from sharing in the lien of the First and Refunding Mortgage), the Court was clearly authorized to restrain any transfers thereof. For, in that event, transfers of the bonds would increase the amount of a class of creditors and thus seriously complicate the consummation of a plan, which is supposed to be executed through the action of a definite percentage of a fixed class.

VII. The order under review is not arbitrary. If it appears to be arbitrary it is only because the petitioners made no suggestion as to any limitations of time or other conditions. Reasonable time limitations and conditions can no doubt be obtained on proper application to the District Court.

VIII. The same principles apply to the pledged St. Paul & Kansas City Short Line Railroad Co. First Mortgage Bonds and the Rock Island, Arkansas & Louisiana Railroad Co. First Mortgage Bonds.

IX. The order under review is authorized as to the bonds of the Subsidiary Debtors even if not guaranteed by the Principal Debtor, as transfers thereof would have created new classes of creditors to be provided for in the plan of reorganization.

X. No point was made below by Reconstruction Finance Corporation with regard to collateral pledged to it which consisted of Mortgage bonds not issued by the Principal Debtor or any of the Subsidiary Debtors.

XI. None of the cases cited by the Petitioners establishes anything contrary to the conclusions expressed above.

XII. The Petitioners are not entitled to interest on their claims after the bankruptcy proceeding commenced.

ARGUMENT

I.

This case does not involve the right of pledgees to sell ordinary collateral.

We do not understand that either in equity or in bankruptcy (including Section 77 of the Bankruptcy Act) a Court has the power to enjoin or control the sale by a pledgee of ordinary collateral. By "ordinary collateral" we mean mortgage bonds or other securities which do not represent any interest in the estate or estates which the Court is administering.

Even assuming that Congress has the power under the Constitution to enjoin the sale of "ordinary collateral" pledged by a bankrupt, we find nothing in Section 77 which indicates that Congress intended to change the rule uni-

versally applied in equity and bankruptcy with respect to "ordinary collateral."

It follows that there is no constitutional question in the case. Nor is there any question of the Court's jurisdiction, since its order related to the transfer of interests in property in the estates which the Court was administering, over which it had jurisdiction *in rem*.

Compare *Straton* v. *New*, 283 U. S. 318, 321.

Nor, we think, is it necessary to determine whether Section 77 should receive a "liberal construction." The General Mortgage Committee, representing underlying bonds, is not necessarily in accord with junior interests as to the "liberal construction" to be given Section 77 (R. 323).

But the order under review was plainly authorized, as to the collateral we will consider, whether Section 77 is given a "liberal construction" or not. The order was authorized as a matter of *necessary construction*, for, in the absence of such an order, it would have been impossible even to formulate a plan of reorganization.

II.

The pledged Chicago, Rock Island & Pacific Railway Company First and Refunding Bonds do not represent debts of the Chicago, Rock Island & Pacific Railway Company. They merely represent fractional interests, held as security only, in property which is part of the principal debtor's estate.

In considering the nature of the collateral with which the Court was dealing we will discuss first The Chicago, Rock Island & Pacific Railway Company First and Refunding Mortgage Bonds, because the points which we wish to

bring out can be stated most simply with regard to the First and Refunding Bonds, and we can then consider to what extent those points apply to the other collateral.

A. The status of the pledged First and Refunding Bonds prior to the bankruptcy.

At the commencement of the proceeding each First and Refunding Bond, *if owned outright by a creditor,* had two attributes. It constituted:

(1) an obligation of The Chicago, Rock Island & Pacific Railway Company to pay the amount of money specified in the bond, and

(2) a fractional interest in the lien of the mortgage held to secure the obligation named in the bond.

It is quite obvious, however, that a *pledged* First and Refunding Bond did not have the same two attributes. For example, if we take the Bonds pledged to the Chase National Bank of New York (R. 39), we find that

(1) such a pledged bond was *not* a debt or obligation of The Chicago, Rock Island & Pacific Railway Company, for the debt which the latter owed the Chase National Bank was $2,000,000, and the face amount of the pledged First and Refunding Bonds held by the Chase National Bank (in addition to other collateral) was $3,253,000;

(2) such a pledged bond did represent a fractional interest in the First and Refunding Mortgage held as security only; but the fractional interest so held did not secure a claim for the face of the bond, and was simply part of pledged property securing a debt or claim of $2,000,000.

The fact that on their face the pledged bonds may not have been distinguishable from the bonds owned outright

except by their numbers is immaterial. *They were not debts* and no one treated them as such. The amounts specified in the bonds simply determined the extent of the fractional interests in the lien of the mortgage held as security for the single debt to the Chase National Bank. The words in the bonds, phrased as promises to pay money, had given rise to no obligation to pay the amounts specified in the bonds.

B. When the order appealed from was entered in the District Court on November 22, 1933, the pledged bonds still had the same attributes which they had before the commencement of the proceeding.

Leaving aside for the moment all questions as to the effect of the commencement of the proceeding or the order appealed from, it is evident that, since the pledged bonds were held by the pledgees on November 22, 1933, and are still so held, they did not constitute debts on November 22, 1933, and do not constitute debts today, any more than they did the day they were pledged.

III.

As a result of the commencement of the proceeding under Section 77 of the Bankruptcy Law, each pledgee is simply a secured creditor of the principal debtor, holding a single claim. Transfers of the pledged First and Refunding Bonds, if recognized, would be merely transfers of ratable shares of the lien of the mortgage. No pledgee has any power to transform the pledged bonds into debts by transferring them to someone else.

Irrespective of the order appealed from, *the commencement of the bankruptcy proceeding* had an immediate and

important effect on the rights and remedies theretofore available to the pledgees, and that effect followed constitutionally and necessarily by virtue of the provisions of the Bankruptcy Act itself.

As a preliminary to a consideration of the effect of the bankruptcy of the Principal Debtor, we wish to emphasize the fact that the pledgees not only loaned money to a railroad corporation which became bankrupt, but that they loaned it principally, and in some cases solely, on the security of bonds of that bankrupt. There is no reason why the bankruptcy of the Principal Debtor should not have, and should not have been expected to have, an important effect on the rights and remedies of the pledgees. Much as the pledgees may now write of the liquid character of the loans they made, it is clear that the security they took was very different from what it would have been if it had consisted of bonds of companies other than the bankrupt.

A. The status of the pledged bonds is to be determined by the Bankruptcy Act.

Subdivision (n) of Section 77 provides:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and his property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

No provision could be clearer. Where "consistent with the provisions of Section 77 the rights * * * of creditors and of all persons with respect to the debtor and his (*sic*)

property shall be the same as if" The Chicago, Rock Island & Pacific Railway Company had been adjudicated a bankrupt on June 7, 1933 (R. 2-5).

It is true that under Section 77 there will be no such liquidation as takes place in an ordinary bankruptcy proceeding. But "claims and interests" in a debtor's estate, including secured claims, must be valued before the provision to be made for them can be decided upon (subdivision [g]; Appendix to R. F. C. Brief, pp. 101-102). The valuations may not be formal ones, represented by orders or decrees, but the plan must reflect proper appraisals of the respective "claims and interests" to be affected; otherwise the plan will not be equitable (subdivisions [d] and [g], Appendix to R. F. C. Brief, pp. 98, 101).

In an ordinary bankruptcy mortgaged properties or any proceeds thereof are distributable to the mortgagees, unless there be an excess over the liens; if there be one, it becomes part of the free assets of the estate. Secured creditors have both their security and, if that is inadequate, deficiency claims based on the amount of the debts due them (Section 57 [h]). Deficiency claims result in dividends out of the free assets. Under Section 77 there will, we assume, be no actual dividends out of free assets, but the right to such a dividend if there were a liquidation and distribution is an element of value in a secured creditor's claim which must be recognized in determining what a secured creditor shall receive. In discussing the rights of the Petitioners, we shall consider the situation as if there were to be an actual distribution of the free assets in the estates of the several Debtors, since for all practical purposes the situation is just the same as if there would be such a distribution.

B. In bankruptcy a creditor holding unsecured bonds of the bankrupt as security cannot prove a claim on the bonds themselves, but can only prove for the amount actually owing.

It is elementary that, with certain exceptions not material here, a debt must be *owing* at the commencement of a bankruptcy proceeding in order to be the basis of a provable claim which will entitle the holder to share in the free assets of the estate.

Section 63 (a) of the Act provides:

> "*a*, Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) due as costs taxable against an involuntary bankrupt who was at the time of the filing of the petition against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) founded upon a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) founded upon an open account, or upon a contract express or implied; and (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less cost incurred and interests accrued after the filing of the petition and up to the time of the entry of such judgments."

The date of the commencement of the proceeding is controlling. In *Zavelo* v. *Reeves*, 227 U. S. 625, at page 631, the Court said:

"But, reading the whole of Sec. 63, and considering it in connection with the spirit and purpose of the act, we deem it plain that the debts founded upon open account or upon contract, express or implied, that are provable under Sec. 63a 4 include only such as existed at the time of the filing of the petition in bankruptcy. This court in effect adopted that construction when, in promulgating the General Orders and Forms in Bankruptcy, 1898, under the authority conferred by Sec. 30, a form of discharge was prescribed (Forms in Bankruptcy, No. 59), by which it is ordered that the bankrupt 'be discharged from all debts and claims which are made provable by said acts against his estate, and which existed on the day of A. D., on which day the petition for adjudication was filed him; excepting such debts as are by law excepted from the operation of a discharge in bankruptcy.' And the forms prescribed for proof of debts all declare that the indebtedness existed 'at and before the filing of the said petition.' Forms 31 to 36, inclusive. The General Orders and Forms, etc., are to be found in 172 U. S., Appendix; 89 Fed. Rep. Preface; 32 C. C. A., Preface, 3 Foster's Fed. Pract. (4th ed.) 2526, 2559, 2572."

Forms 31-36, promulgated by this Court and referred to in the *Zavelo* case, all contain an allegation that the bankrupt "was *at and before the filing of said petition*, and still is justly and truly indebted to," etc.

The proposition that a creditor to whom a single debt is owed can prove only a single claim, regardless of the number of unsecured notes or bonds he may hold as "collateral," is well established.

First National Bank of Beaumont v. *Eason* (C. C. A. 5th), 149 Fed. 204;

John Matthews, Inc. v. *Knickerbocker Trust Co.* (C. C. A. 2nd), 192 Fed. 557;

In re Wise Shoes (D. C. S. D. N. Y.), 2 Fed. Supp. 521.

The same rule has been applied in equity.

Union Nat. Bank v. *Peoples Savings & Trust Co.* (C. C. A. 3rd), 28 Fed. 2nd 326;
In re Waddell-Entz Co., 67 Conn. 324;
Third National Bank v. *Eastern R. R. Co.*, 122 Mass. 240;
People v. *Remington*, 54 Hun 480; 121 N. Y. 675.

All the Petitioners apparently concede the correctness of the views above expressed as applied to unsecured bonds pledged by a bankrupt (see R. F. C. Brief, pp. 34, 44-46; Banks' Brief, p. 18).

C. In bankruptcy a creditor holding a mortgage bond of the bankrupt as security only cannot prove a claim on the bond (as distinguished from sharing in the lien of the mortgage), but can only prove for the debt actually owing.

It is obvious that the *principles* applicable to an unsecured bond of a bankrupt held by the bankrupt's creditor as security only must control a mortgage bond of the bankrupt similarly held *as to the matter of proving a deficiency claim based on the amount specified in the bond.* If an unsecured bond of a bankrupt held as security is not a "fixed liability • • • absolutely owing" within the meaning of Section 63 (a) of the Bankruptcy Act, neither is a mortgage bond of a bankrupt similarly held. A pledged mortgage bond of a bankrupt will entitle the pledgee to the benefit of his ratable share of the property subject to the mortgage, and to that extent differs from an unsecured bond of the bankrupt similarly held. But *there is no valid distinction, so far as concerns the*

matter of proving claims in order to share in the free assets, between a pledged unsecured bond and a pledged mortgage bond of a bankrupt.

In re Battle Island Paper Co. (N. D. N. Y.), 259 Fed. 921, is a bankruptcy case in point, as a careful reading will show (pp. 924-926).

And the rule has been applied in equity.

Hitner v. *Diamond State Steel Co.* (C. C. Del.), 176 Fed. 384, 397;
Dibert v. *D'Arcy,* 248 Mo. 617.

An equity case stating the rule is *In re Waddell-Entz Co.,* 67 Conn. 324, from which we quote an excerpt to be found in the Reconstruction Finance Corporation Brief at page 46, footnote 5:

> "A debtor's additional promises to pay cannot, from the very nature of the case, be treated as collateral security for his debt, unless such additional promises are themselves secured by a lien on property or by the obligations of third persons; under such circumstances they may be treated as collateral security so far as is necessary to obtain the benefit of the lien or obligation."

The distinction is well illustrated by this very case. The Petitioners have provable claims against the Principal Debtor, the amount of which will determine their respective shares in the free assets of the Principal Debtor. They also hold First and Refunding Bonds as collateral. They cannot prove claims on the First and Refunding Bonds in order to share in the free assets in the estate of the Principal Debtor. But they have ratable shares in the lien of First and Refunding Mortgage. Having such ratable shares, they have received their proper fractions of everything the Trustees

of the First and Refunding Mortgage have collected during this proceeding on the collateral subject to that mortgage. (R. 341-342). And the pledgees will be entitled to have the value of their ratable shares in the lien of the First and Refunding Mortgage considered in determining what provision is to be made for them in a plan of reorganization.

In other words, while the First and Refunding Mortgage Bonds in the hands of the pledgees have a real value because they constitute ratable shares in the lien of the First and Refunding Mortgage, they do not have either the same value or the same attributes as the bonds which are owned outright. The latter constitute *debts* of the Principal Debtor, and entitle the holders to share in the Principal Debtor's free assets if the security is inadequate. The pledged bonds do not.

D. If the pledged bonds did not constitute debts when the Principal Debtor filed its petition under Section 77, transfers thereof by the pledgees, if recognized, will merely convey to the transferees ratable shares in the lien of the mortgage. For the pledgees cannot transform the pledged bonds into debts by the mere act of transferring them to someone else after the bankruptcy.

If we assume that the pledgees could transfer the pledged First and Refunding Bonds except for the order under review, it is clear that the effect of transfers thereof would have to be to separate the pledged bonds from the debts to the respective pledgees, or else any transfers would be futile.

For example, the Chase National Bank holds $3,253,000 of the First and Refunding Bonds subject to the condition that, if more than $2,000,000, the debt owing to it, be realized on all the collateral it holds, any "equity" will be turned over to the Principal Debtor's estate. Obviously the Chase

National Bank wishes to be free to make an *effective* transfer, one which will enable the transferee to realize on the transferred bonds without any restriction or any duty to account for any "equity."

It follows, therefore, that what the pledgees wish to do is to transfer ratable shares of the lien of the First and Refunding Mortgage, to be held by the transferees free and clear from any duty, such as is now owed by the pledgees, to account for any "equity" which may be ultimately realized thereon. Assuming that the pledgees can do this, if permitted to do so by the Court, it is clear that they cannot also transform the pledged First and Refunding Bonds into debts by the mere act of transferring them to some one else.

This proposition is necessarily true, because under Section 63 (a) *the test is whether the pledged bonds constituted fixed liabilities "absolutely owing" when the proceeding commenced.*

A recent able article in the Harvard Law Review, Vol. XVII, at pages 1092-1126, entitled *"A Form of Depression Finance-Corporations Pledging Their Own Bonds,"* by Sinclair Hatch, points out clearly that even if a pledgee is allowed to transfer mortgage bonds of a bankrupt held as collateral, it does not mean that the purchaser can prove a claim for the face of the pledged bonds, as distinguished from sharing ratably in the lien of the mortgage (pp. 1119-1120). The author correctly analyzes (pp. 1123-1124) the case of *In re Battle Island Paper Co.*, 259 Fed. 921, referred to above, in which the Court, inferentially at least, held that a pledgee could not give a third party a right to prove a deficiency claim on mortgage bonds on which the pledgee itself could not prove a claim.

It seems to us clear that unless all the cases cited at pages 20-22 above were erroneously decided, a pledgee of

mortgage bonds of a bankrupt has no power after the bankruptcy proceeding has commenced to "sell his collateral," if by that is meant to convey to a purchaser mortgage bonds having the same attributes as bonds of the same issue already outstanding in the hands of outright purchasers. For in one respect a mortgage bond is exactly like an unsecured bond—it contains words embodying a promise to pay money—and if a pledgee of an unsecured bond of a bankrupt cannot prove a claim in order to share in unmortgaged assets, and cannot give any one else the power to prove such a claim by transferring the bond, there is no rational basis for holding that a pledgee of a mortgage bond of a bankrupt can prove or give anyone else the power to prove on such a bond for the purpose of sharing in the free assets of the bankrupt.

Indeed, it would be incongruous to hold that the Chase National Bank, for example, cannot prove a claim for $3,253,000 in order to share in the free assets, because the debt to it is only $2,000,000, but that, *after the bankruptcy,* the Chase can transfer the First and Refunding Bonds to someone else who can prove a claim for $3,253,000. If such were the law, would not every secured creditor holding mortgage bonds of a bankrupt transfer them, because in the hands of a transferee they would have a greater value than in his own hands, and he could realize that greater value by making a transfer?

In the last analysis, the question is whether the principle that two claims cannot be proved on a single debt is sound. It seems to be well established. If it is sound, there is no rational basis for failing to apply it irrespective of transfers made after bankruptcy, and to mortgage bonds as well as to unsecured bonds.

E. The fact that the pledged mortgage bonds may appear from a casual inspection to be negotiable instruments is immaterial.

"The filing of the petition is a *caveat* to all the world and in fact an attachment and injunction."

May v. *Henderson,* 268 U. S. 111, 117;
Gross v. *Irving Trust Co.,* 289 U. S. 342, 344.

And see

In re Charles R. Partridge Lumber Co. (D. C. N. J.), 215 Fed. 973, 975.

In other words, when bankruptcy takes place, the Bankruptcy Law simply supersedes the Negotiable Instruments Law *as to matters affecting the distribution of the bankrupt estate,* such as the status of pledged bonds which represent fractional interests in property in the estate.

F. Decisions relating to transfers of pledged collateral in equity proceedings have no bearing here.

An equity proceeding is not a statutory proceeding. The filing of a creditor's bill is not the equivalent of a petition in bankruptcy.

Wm. Filene's Sons Co. v. *Weed,* 245 U. S. 597, 601.

We have cited certain equity cases because the principles they announce apply *a fortiori* to a bankruptcy case in view of the express provisions of the Bankruptcy Act. It does not follow that other equity cases, if inconsistent with the provisions of the Bankruptcy Act, afford a guide in this case.

IV.

Section 77 of the Bankruptcy Act contemplates action by the various classes of "creditors." The transfer of the pledged First and Refunding Bonds, if recognized in the bankruptcy court, would create a new class of "creditors" as defined in Section 77.

Formulation of a plan would be impossible if transfers of the bonds were to be permitted without control and recognized, because it would be impossible to know what classes to provide for and what claims.

By statutory definition the word "creditors" as used in Section 77 has a broader meaning than usually attaches to it (Subdivision b):

> "The term 'creditors' shall, except as otherwise specifically provided in this section, include, for all purposes of this section and of the reorganization plan, its acceptance and confirmation, all holders of claims, interests, or securities of whatever character against the debtor or its property, including claim for future rent, whether or not such claims, interests, or securities would otherwise constitute provable claims under this act."

Thus a "creditor," as the word is used in Section 77, may be one holding merely an "interest" in the estate, such as a fractional interest in the lien of a mortgage on property in the estate, and may not hold a debt; whereas in an ordinary bankruptcy proceeding a "creditor" is always one to whom a debt is owed absolutely at the commencement of the proceeding.

The cardinal feature of Section 77 is that it provides for action by percentages of the various classes of "creditors," as thus defined. Ten per cent of a class may present a plan (Subdivision [d], Appendix to R. F. C. Brief, p. 98). Two-thirds of a class may accept a plan for the class (Sub-

divisions [e], [g], [h], Appendix to R. F. C. Brief, pp. 98-99, 101-103).

For the protection of the "creditors," Subdivision (g), clause 6, provides that the Court must be satisfied that:

> "* * * the plan provides with respect to any class of creditors the acceptance of which is requisite to the confirmation of the plan, and who would not become bound by the plan under the provisions of subdivision (h) of this section, adequate protection for the realization by them of the value of their securities, liens, and claims, either (a) by the sale of such property subject to their liens, if any, or (b) by the sale free of such liens at not less than a fair upset price, and the transfer of such liens to the proceeds of such sale, or (c) by appraisal and payment in cash of either the value of such liens and claims or, at the objecting creditor's election, the value of the securities allotted to such liens and claims under the plan."

Recognizing the necessity of dividing the "creditors" into fixed classes, clause 5 of Subdivision (c) of Section 77 provides that the Court:

> "* * * shall determine a reasonable time within which the claims and interests of creditors and stockholders may be filed or evidenced, and after which no such claim or interest may participate in any plan except on order for cause shown; the manner in which such claims and interests may be filed or evidenced and allowed, and, for the purposes of the plan and its acceptance, the division of creditors and stockholders into classes according to the nature of their respective claims and interests."

It will be clear upon the briefest reflection that it is essential to have the classes of "creditors" remain fixed, or at least substantially fixed, if a plan is to be formulated and go through the successive stages contemplated by Section 77.

A. Each of the pledgees belongs within a single class of "creditors"; its total claim falls within that class; and its collateral does not fall within any other class, or entitle the pledgee to vote in another class.

It is obvious that each of the pledgees has but a single claim and can be in but a single class of "creditors." Whether all of the pledgees fall in the same class is immaterial (See Appendix to R. F. C. Brief, p. 139). No one "creditor" having a single claim can be in more than one class.

The contrary view expressed in the Reconstruction Finance Corporation Brief at pages 91-92 seems to us so plainly mistaken that no extended discussion is required. The plan of reorganization must provide for the whole claim of the Reconstruction Finance Corporation. In making provision for the claim, it is obvious that all the collateral which secures the claim must be considered; the provision will not be "equitable," as required by Section 77, unless it recognizes the value of the collateral and also the value of any deficiency claim against free assets. There is, therefore, no possible reason why the Reconstruction Finance Corporation should have a vote in any other class.

If a creditor's claim can be voted not only in the class in which it belongs but also in any class in which its security would fall if owned outright an impossible situation would exist. For example, there are $61,581,000 General Mortgage Bonds owned outright and $38,400,000 pledged under the First and Refunding Mortgage (R. 33, 59). Should the latter be counted and voted as if owned outright? Can they be voted with $28,254,000 of the outstanding General Mortgage bonds and bind $33,327,000 dissenting outstanding bonds?

The St. Paul and Kansas City short Line Bonds afford an even clearer example. There are $9,981,265 outstanding

bonds in the hands of the public and $17,828,250 pledged to the Reconstruction Finance Corporation and the Banks (R. 20-21, 37-39). If the plan provides that the pledgees shall receive cash in full for their claims but that the Short Line bondholders will get less than what they believe to be fair, can the pledgees buy less than $1,000,000 additional Short Line bonds and vote two-thirds of the class in favor of the plan?

A plan must provide for a creditor's whole claim, including any collateral. To allow a creditor, whose whole claim must be provided for anyhow, to vote in the various classes in which its collateral would fall if owned outright would be incongruous. The creditor could not want a vote in other classes in order to protect its own claim, but only to keep others from protecting theirs.

Furthermore, as already pointed out, the pledged bonds of the type we have been discussing do not represent the same legal rights as are represented by the bonds of the same issue which are owned outright (See pp. 21-23). If provable as "interests" in the estate although not "claims," the pledged bonds would fall in a different class from the bonds owned outright.

B. If the pledgees can transfer the pledged First and Refunding Bonds, the effect will be to create a new class of "creditors" to be provided for in the Plan.

If the pledgees have the right to transfer the pledged First and Refunding Bonds, and transfers thereof must be recognized in the proceeding, the pledgees have the power to create a new class of "creditors" at will.

The classification provided for under Section 77 has been universally understood to require the division of the "creditors" into classes of substantially identical "claims"

or "interests" (See Appendix to R. F. C. Brief, pp. 133-142). If this were not so, and a single class could contain "creditors" having different "claims" or "interests," a two-thirds majority in one class might bind a minority having substantially adverse interests.

The holders of the First and Refunding Bonds which are owned outright are entitled to share in the free assets in the estate of the Principal Debtor as well as to share in the lien of the Mortgage. Neither the pledgees nor any transferees of the pledgees could have any claim against the free assets based on the pledged bonds. The difference is a substantial one. There is evidently going to be a very large deficiency on the First and Refunding Bonds.

It necessarily follows that, if the pledged First and Refunding Bonds be transferred and the transfers be recognized in the bankruptcy proceeding, *the effect will be to create a new class of "creditors," the amount of which will depend on the amounts of the bonds transferred and which will thus be subject to the whim of the pledgees.* For the transferees will acquire bonds, which will represent "interests" in the estate (that is, interests in the property subject to the First and Refunding Mortgage), but which will not represent *debts* and will not entitle the holders to prove deficiency claims against the estate of the Principle Debtor.

It is obvious, for example, that the Chase National Bank now has a single claim for $2,000,000, which belongs in one class, and which will continue to belong in that class no matter how many pledged bonds it might transfer, unless the whole claim be discharged. Transferees of the pledged bonds would fall into an entirely new class, since their rights would be different from those of the holders of the

First and Refunding Bonds now owned outright, who constitute a class of "creditors" (Appendix to R. F. C. Brief, p. 135).

The creation of a new class of "creditors" necessarily results when such "interests" held as collateral to secure a single "claim" are separated from the "claim." A "creditor" is one holding either a "claim" (a debt) or an "interest" (see *ante*, p. 27). The pledged First and Refunding Bonds are "interests" held to secure a single "claim." If, for example, the Chase National Bank were to assign its entire "claim" and security "interests," it would be a different matter. So also, if, with the approval of the Court, it were to split up its claim and were to transfer the fractions of the claim, a proportionate fraction of the security "interests" going to each transferee of a fraction of the "claim," the transferees would fall in the same class which now includes the Chase National Bank. But a separation of security which consists of "interests" in the estate from the "claim" which the "interests" secure necessarily has a different effect.

Counsel for the Petitioner Banks attempt to controvert these propositions (pp. 57-59, footnote 16), but their argument seems clearly unsound. It is perfectly true, as they say, that transfers of entire claims *within a class*, the amount of which is fixed, do not present a serious complication. Thus holders of the $104,470,000 First and Refunding Bonds (R. 4) outstanding in the hands of the public (Appendix to R. F. C. Brief, p. 42) can transfer them freely without causing any complications, at least at this time. They constitute a class of creditors, fixed in amount, and a mere assignment of entire claims within a fixed class presents no problem (Appendix to R. F. C. Brief, p. 135).

But a transfer of any of the pledged bonds would *create a new class of creditors*. There are $56,582,000 of the pledged

First and Refunding Bonds. (Appendix to R. F. C. Brief, p. 42). We are concerned here with $13,530,000 of them (see *ante*, p. 8). How can a plan be formulated if a new class of "creditors" can be created at any time, and the amount of "creditors" of that class increased at any time by the transfer of additional pledged bonds?

C. Section 77 must be construed to authorize the Court to control the transfer of the pledged bonds.

It is obvious that Section 77 must be construed to authorize the Court to *control*, in the exercise of a sound judicial discretion, the transfer of the pledged bonds. As will be noted below, this does not mean that such transfers should be prohibited perpetually or unconditionally. But it does mean that the pledgees cannot possess the power to create new classes of "creditors" at will; for, if they can, no plan can be formulated.

It is equally clear that the Court below could have obtained the same result by an order expressly made under clause 5 of subdivision (c) of Section 77, quoted above at page 28. Such an order need only have provided that the classes of "claims and interests" were fixed, and that no new class of "claims and interests" could be created.

V.

The assignment after bankruptcy of "claims" against or "interests" in a bankrupt estate is not a matter of constitutional right, and such assignments are subject to such control as may be authorized by statute.

It cannot be seriously disputed that Congress, in the exercise of its bankruptcy power, can establish rules governing

the administration of the estates of bankrupts. Nor can there be any doubt that provisions relating to the assignment of "claims" or the transfer of "interests" in a bankrupt estate held to secure a claim against a bankrupt would fall within the scope of the authority of Congress.

In ordinary bankruptcies such assignments and transfers are restricted. Assignments of entire claims must conform to General Order XXI. And as to transfers of pledged bonds held as security, it is clear that, even if such transfers would create new debts provable under Section 63(a) (which we deny), the transfers would have to be made within the six months period prescribed by Section 57(n) in order to enable the transferees to prove claims.

More important, the Petitioners have not been able to cite a single case holding that transferees of pledged mortgage bonds, held by a secured creditor as security for a single claim, can prove claims (as distinguished from sharing in the lien of the mortgage), in an ordinary bankruptcy case. All of the authorities indicate that the reverse is the case (see *ante*, pp. 19-26).

If, *before a bankruptcy*, a pledgee, holding mortgage bonds issued by the pledgor, transfers the bonds, new *debts* are created, and the transferees can prove deficiency claims and share in the free assets in the bankrupt estate as well as in the lien of the mortgage. But if a transfer be made, *after bankruptcy*, the effect is different, and the transfer, if recognized, simply amounts to splitting up and assigning "interests" in the estate held to secure a single claim. Entirely different rules apply.

There is nothing "unreasonable, arbitrary or capricious" about this (cf. *Nebbia* v. *New York*, 291 U. S. 502, 505). It is an accepted principle that two claims cannot be proved on a single debt. At the same time it is true that a borrower

can pledge a second promise to secure a debt, and that a pledgee thus has the power to create an additional debt by a transfer after default but *before bankruptcy*. The bankruptcy is thus the dividing line. This, of course, is not the only respect in which the commencement of a bankruptcy proceeding is a dividing line; nor is the commencement of the proceeding the only dividing line established by the Bankruptcy Act in fixing the rights of creditors (Sec. 60).

As Mr. Hatch says in his article, referred to above at page 24 (p. 1115):

> "If insolvency of the pledgor corporation is to terminate the pledgee's rights under the power of sale, the actual institution of bankruptcy or other insolvency proceedings represents the most practical dividing line between the time when a power of sale may properly be available and the time after which its exercise is no longer permissible."

But, whatever the law may be in an ordinary bankruptcy proceeding, Section 77 has certain features not to be found in an ordinary bankruptcy. Those include (a) the classification of creditors, (b) the action of the creditors by classes as fixed and (c) the determination by the Court *in its discretion* of the time when "claims and interests" must be proved. Railroad reorganizations such as are contemplated by Section 77 are necessarily complicated. This is particularly true where, as here, there are several estates in one proceeding, and the plan of reorganization will presumably affect all. Section 77 necessarily contemplates a relatively fixed framework on the basis of which a plan can be constructed.

No one has challenged the constitutionality of Section 77 in so far as it provides for action by classes of creditors. Despite all that has been written about the purposes of Section 77—the abuses of equity receiverships, the need to help

the railroads, etc.—it seems to us that the cardinal feature of Section 77 is that it provides that two-thirds of one class of creditors can bind the entire class. This feature presupposes that creditors shall not change the framework on which a plan must be constructed, except subject to the control of the Court.

VI.

Even if we are wrong in assuming that transferees of the pledged First and Refunding Bonds could not prove claims for the face amount thereof (as distinguished from sharing in the lien of the First and Refunding Mortgage), the Court was clearly authorized to restrain any transfers thereof.

Our position, as already stated, is that, to take a specific example, the Chase National Bank had a claim for only $2,000,000 when the proceeding was commenced, and, since the pledged First and Refunding Bonds totalling $3,253,000 did not represent a *debt,* the Chase National Bank could not create an additional debt after bankruptcy by transferring them; that a transfer, if recognized, would create a new class of "creditors" as defined by Section 77, since the holders of the transferred pledged bonds would have different rights from those of the holders of the bonds which were owned outright when the bankruptcy was commenced; and that any attempts to transfer the bonds should therefore be controlled by the Court.

Let us assume, however, that we are mistaken as to the *effect* of transfers of the pledged bonds if transfers were permitted and that the transferees could prove for the face amount of the bonds and be entitled to share accordingly in the free assets in the Principal Debtor's Estate. If so,

it is clear that a transfer, if recognized, would *increase the amount of a class of creditors,* and thus seriously complicate the consummation of a plan which is supposed to be executed through the action of a definite percentage of a fixed class.

There are $104,470,000 First and Refunding Bonds outstanding in the hands of the public and $56,582,000 pledged (Appendix to R. F. C. Brief, p. 42). Let us assume that a plan is presented and approved by the Interstate Commerce Commission as provided in subdivision (d) of Section 77 (*id.*, pp. 97-98). The creditors are then asked to accept it. Of the $104,470,000 First and Refunding Bonds, $70,000,000, let us say, accept it—a clear two-thirds. The plan provides that the pledgees shall be paid in full in cash, but they do not choose to await its consummation. During the period while the acceptances are being obtained the pledgees start to sell the pledged bonds—a thousand one day, a million the next. No one knows how many have been sold—how many are still in pledge. No one knows how many bonds are in the class at any time, how many will be in the class at any future time, or what two-thirds of the class is or will be. How could a plan be consummated with such a situation?

Experience in equity receiverships affords no criterion. The pledging by a railroad corporation of its own mortgage bonds, while not novel, has never reached such proportions or presented such a variety of complications.

VII.

The order under review was not arbitrary. If it appears to be arbitrary, it is only because the petitioners made no suggestions as to any limitations of time or other conditions. Reasonable time limitations and conditions can no doubt be obtained on proper application to the District Court.

From reading of the Petitioners' Briefs it might be supposed that they pleaded with the District Court for the insertion of limitations of time or other conditions in the order under review, and that the Court arbitrarily refused to consider their plea and perpetually enjoined any transfers of pledged bonds on any terms whatsoever.

The fact of the matter is, however, that in the District Court the pledgees stood on what they conceived to be their constitutional or statutory right to transfer the pledged bonds at such time or times and on such terms as they might choose without regard to the effect of any transfers on the proceeding and any plan. And they made no suggestions whatever that any limitations of time or other conditions be inserted in the order, as an examination of the papers in the record filed by them will show (R. 68-75).

They apparently now expect to benefit by their own failure to suggest any limitations of time or other condition, for they point to the absence thereof as evidence of an arbitrary act on the part of the District Court and write eloquently of the delay in presenting and consummating a plan of reorganization.

This discussion of delay, which is to be found particularly in the Reconstruction Finance Corporation Brief, at pages 100-102, is supplemented by a reference to a meeting held on October 11, 1934, at which it appeared that no plan of re-

organization had been formulated, and that there was at that time no immediate prospect of any plan (R. F. C. Brief, pp. 101-102; Appendix to R. F. C. Brief, pp. 167-173). While it may hardly be relevant, it is only fair to point out that the reasons why no plan has been formulated are fully set forth in a letter from the Debtor's Trustees to the Director of the Bureau of Finance of the Interstate Commerce Commission, dated December 13, 1934, which is printed in the Appendix to the Reconstruction Finance Corporation Brief at pages 167-173; that at a meeting of the interested parties held on October 11, 1934, no one present suggested "that it was possible or feasible, or the duty of the Trustees, to present a reorganization plan at this time" (Appendix to R. F. C. Brief, p. 172); that among those present were two representatives of the Reconstruction Finance Corporation (*id.*, p. 170); and that the references in the Reconstruction Finance Corporation Brief to "protracted delay" (p. 102, footnote 40) cannot have been intended as a criticism, because if any criticism were to be made it would apply to the Reconstruction Finance Corporation to the same extent as to any other party in interest.

Reverting to the terms of the order under review, we do not suggest that the Court below may or should prohibit indefinitely any transfers of the pledged mortgage bonds on any conditions whatever. All we contend is that the Court should be permitted to *control* any transfers. The action of the Court will presumably be based on a sound judicial discretion both as to *time* and as to *terms*.

As to *time* the pledgees already have a remedy under clause 7 of subdivision (c) of Section 77, which provides that the Judge

> "if a plan of reorganization is not proposed or accepted, or, if proposed and accepted, is not confirmed,

> within such reasonable time as the judge may, upon cause shown and after considering any recommendation which has been filed by the commission, allow, may dismiss the proceeding."

In addition the Court may, without dismissing the proceeding, permit a transfer if it is satisfied that it is reasonable to do so. The Circuit Court of Appeals expressed the view that special speed may be required under Section 77 (R. 325). We do not quite see why the statute itself does not provide the criterion when it provides for a "reasonable" time, which we assume would be determined fairly. The pledgees have no reason to fear a perpetual "freezing" of their position.

In the matter of *terms*, it is clear, for example, that if the Chase National Bank should wish to transfer its First and Refunding Bonds, and the terms of the transfer did not break down the framework on which the plan must be formulated, the transfer should be permitted. The framework on which a plan must be formulated could be preserved, for example, by requiring the transferee to look only to the Chase National Bank for any recovery in the proceeding; there would be no changes in the classes of creditors, and no one but the Chase Bank and the transferee would be really affected.

The sum and substance of the present situation is that, if the District Court had the *power* to control attempted transfers of the pledged bonds, no question is now presented to this Court as to what limitations of time or other terms would be proper. The pledgees are merely restrained from making the transfer "until further order of this Court" (R. 104). If the pledgees had asked for the insertion of a reasonable limitation of time or other reasonable conditions and none had been inserted, the situation would be different.

VIII.

Everything heretofore said with respect to The Chicago, Rock Island & Pacific Railway Company First and Refunding Mortgage Bonds applies equally to the St. Paul & Kansas City Short Line Railroad Co. First Mortgage Bonds and the Rock Island, Arkansas & Louisiana Railroad Co. First Mortgage Bonds.

The second class of collateral referred to at pages 8-9 above consists of the St. Paul & Kansas City Short Line Railroad Co. First Mortgage Bonds and the Rock Island, Arkansas & Louisiana Railroad Co. First Mortgage Bonds.

The principles discussed above which apply to The Chicago, Rock Island & Pacific Railway Co. First and Refunding Mortgage Bonds all apply equally to the pledged bonds of these two issues, although their legal status is not exactly the same.

Each of the two corporations is a wholly owned subsidiary of the Principal Debtor (R. 23); all of the properties of each are operated by the Principal Debtor under leases of 99 and 999 years respectively (R. 23); the bonds of the two subsidiaries are guaranteed by the Principal Debtor (R. 4, 29, 20-21, 31); and the two Subsidiary Debtors are Debtors in this same proceeding (R. 23-28).

We entirely agree with the Petitioners that, while the Principal Debtor and the Subsidiary Debtors are all debtors in the same proceeding, and a single plan may be proposed and confirmed as to all of them, they have separate estates. We further agree that the Trustees, as Trustees of one estate, may have claims against another estate. But the fact that the St. Paul & Kansas City Short Line Railroad Co. First Mortgage Bonds and the Rock Island, Arkansas & Louisiana Railroad Co. First Mortgage Bonds are guaranteed by the Principal Debtor has the effect of making every principle dis-

cussed above with regard to the First and Refunding Mortgage bonds apply to them.

We take it that there is no doubt that the holders of bonds of these two issues, *if owned outright*, have provable claims against the estate of the Principal Debtor and are entitled to share in the free assets of the estate of the Principal Debtor, their ratable shares therein to be determined by the amount of their deficiency claims.

Maynard v. *Elliott*, 283 U. S. 273.

The outstanding bonds, *if owned outright*, thus have three attributes. They are: (1) ratable shares in the lien of the relevant mortgage; (2) debts, which form the basis of provable claims against the Subsidiary Debtor issuing the same; and (3) contingent obligations of the Principal Debtor, which form the basis of provable claims against the Principal Debtor.

It seems equally clear, however, that, unless bonds of these issues are owned outright, they do not possess the third of these three attributes.

It may be true, as stated in the Brief of the Reconstruction Finance Corporation at page 93, that, even prior to the pledge of the bonds, the Principal Debtor as the owner thereof was entitled to share in the lien of the mortgage and to enforce the debt of the Subsidiary Debtor evidenced by the bonds. If so, the bonds thus had two of the three attributes of the outstanding bonds which were owned outright. But obviously they did not at that time have the third attribute, because, being held by the Principal Debtor itself, they did not constitute obligations of the Principal Debtor. A corporation cannot be under any contractual obligation to itself.

Our position is that after the pledges the bonds continued to have the same legal attributes, so far as this bankruptcy

proceeding is concerned, as they had before the pledges, for the reason that they were pledged to secure a debt of the Principal Debtor. And the Principal Debtor's guarantee was a nullity, so far as the pledgees were concerned, unless the pledgees sold the bonds prior to the bankruptcy, because the pledgees could not prove claims on the guarantee in the bankruptcy proceeding—their claims being only for the amounts which the Principal Debtor owed them respectively.

Viewing the legal status of the pledged bonds as they affect the estate of the Principal Debtor, their status is not substantially distinguishable from that of the Principal Debtor's First and Refunding Bonds. The fact that the bonds of the Subsidiary Debtors did constitute, from the time of their issue, oligations of the Subsidiary Debtors, does not afford a basis for changing the principles applicable to them in this proceeding.

In the Reconstruction Finance Corporation Brief it is asserted that transfers of these subsidiary bonds after the commencement of the bankruptcy proceeding would not, if recognized, result in an "increase of a debt structure" (p. 94), since they already represent obligations of the Subsidiary Debtors. But such transfers, if acknowledged to give the pledged bonds the status now held by the outstanding bonds which are owned outright, would increase the liabilities of the Principal Debtor on the basis of which its free assets are to be distributed, and would increase the amounts of claims in established classes of creditors which must remain fixed if a plan is to be formulated. And, if such transfers did not give the pledged bonds the status of the outstanding bonds, a new class of "creditors" would be created.

In the Brief submitted on behalf of the Banks it is argued that transfers of these pledged bonds of the Subsidiary Debtors would have no substantial effect even if the result

were to create new liabilities of the estate of the Principal Debtor, since the Principal Debtor could require a Subsidiary Debtor "to reimburse it for any payments it might be compelled to make upon its guarantee" (p. 57, footnote 14). But this contention is clearly fallacious. Any claim which the Principal Debtor might have against a Subsidiary Debtor for reimbursement on account of a loss sustained through the performance of a guarantee would not be a preferred claim, and the Principal Debtor could at the most recoup only such dividend, if any, as might be distributable out of the free assets of the Subsidiary Debtor in question.

It remains only to clear up any possible doubt as to the fact that these two issues of bonds of Subsidiary Debtors are guaranteed by the Principal Debtor. The record is perfectly explicit on the point (R. 4, 29, 20-21, 31). But in the Reconstruction Finance Corporation Brief (p. 93 footnote 37) the curious suggestion is made that the statements in the record as to the guarantee are "contradicted by other statements that the debtor agreed to pay the *interest* as *rental* (R. 29) in which case the transaction, being a lease, would be voidable by the Trustees." (Italics in original.) There is no contradiction at all. The record shows that the bonds are guaranteed as to principal and interest. It also shows that under the terms of the Rock Island, Arkansas & Louisiana Railroad Co. lease the interest on the bonds constitutes either all or part of the rental payable. This is no contradiction or inconsistency. The guarantees of the bonds outstanding in the hands of the public constitute obligations of the Principal Debtor to the holders of the bonds which obviously cannot be affected by a disaffirmance of the lease. The agreement of the Principal Debtor in the lease to pay the interest on the bonds as all or part of the rental is a separate obligation of the Principal Debtor to the Subsidiary Debtor.

IX.

The order under review was authorized as to bonds of the Subsidiary Debtors even if not guaranteed by the Principal Debtor.

As to the third class of collateral referred to at pages 9-10 above, which is held by the Reconstruction Finance Corporation (all of the collateral held by the Banks falling in the first two classes), the question presented is somewhat different. This third class includes bonds issued by wholly owned Subsidiary Debtors but which are not guaranteed by the Principal Debtor.

We submit, that the District Court clearly had the power to control transfers of these bonds of Subsidiary Debtors also.

The reason why it had such power under Section 77 is because transfers of these bonds would have the effect of creating new classes of creditors which would have to be provided for under the plan of reorganization. While it is true that the purchasers of the bonds would not be creditors of the Principal Debtor, the purchasers would fall into new classes of creditors which would have to be provided for in a plan and which will not exist so long as the pledged bonds are held by the pledgees.

It is quite evident that Section 77 contemplates a single plan of reorganization, to affect at one and the same time the properties of such a railroad corporation as The Chicago, Rock Island & Pacific Railway Company and the subsidiary corporations which become debtors in the same proceeding (Appendix to R. F. C. Brief, p. 91). It seems equally clear that when bonds of a subsidiary debtor are held in the treasury of a principal debtor, or are held by pledgees to whom the principal debtor has pledged them, it is unnecessary to treat the holders thereof as constituting a class of creditors.

If the bonds are held in the treasury of the principal debtor, a plan of reorganization will have to recognize their status as a free asset of the principal debtor or it will not be equitable (Section 77, subdivisions [d], [f] and [g]; Appendix to R. F. C. Brief, pp. 98, 100-102). Similarly, if pledged bonds of a subsidiary debtor are in the hands of a secured creditor of the principal debtor, their status and value must be taken into consideration in the plan, both in determining what provision is to be made for the claim of the secured creditor and in allowing for the equity over its claim if there be any equity. But so long as an entire issue of bonds of a subsidiary debtor is held in the treasury of the principal debtor or by a pledgee of the principal debtor, the holder of such bonds is not properly to be considered as constituting a class of creditors to be provided for under a plan. If, however, such bonds are owned outright, their holders will clearly constitute a class of creditors who will have to be provided for and may vote as such a class with regard to a plan.

Therefore, if secured creditors of the Principal Debtor have the power to sell at will the pledged bonds of a Subsidiary Debtor, they will be able to complicate the presentation and confirmation of a plan seriously. For example, the third class of pledged bonds referred to above at pages 9-10 consists of six different issues, all of which are held by the Reconstruction Finance Corporation. In the order classifying the creditors the Reconstruction Finance Corporation's entire claim is included in a class (Appendix to Brief of R. F. C., p. 139, class 22). But there are no classes representing the issues of The Chicago, Rock Island & Gulf Railway Co., Rock Island & Dardanelle Railway Co., Rock Island Memphis Terminal Railway Co., and Rock Island Omaha Terminal Railway Co. If the Reconstruction Finance

Corporation were to sell all of these bonds there would be six new classes of creditors, the amount of whose claims would be as set forth above at pages 9-10. The Reconstruction Finance Corporation might decide to sell only part and not all—perhaps part of all of the issues, or all of some and part of others and none of still others. We do not see how there can be any doubt that, if the Court cannot control such transfers, the pledgee would have the capacity seriously to complicate the presentation and confirmation of a plan.

Viewing the question as involving the *power* of the District Court, it seems to us that there can be no question that it did have the power to control any attempted transfers of "collateral" of this kind. As to the *terms* on which such a power should be exercised in the event of an application by the Reconstruction Finance Corporation for leave to transfer bonds of this class, it may be that there are factors involved in attempted transfers of the bonds of the first two classes which do not apply to this class, and that the District Court might properly take into consideration the absence of such factors in determining whether to permit sales of bonds of this class on an application for leave to sell them.

X.

No point was made below by Reconstruction Finance Corporation with regard to the fourth class of collateral.

The facts with regard to this class of collateral, which is not relatively important, are given above at pages 10-11. As to the Rock Island Improvement Company bonds, which apparently constitute the most valuable part of the class, they differ from the third class only in that the Rock Island

Improvement Company has not yet become a Subsidiary Debtor in the proceeding.

The Reconstruction Finance Corporation made common cause below with the Banks, who have only collateral of the first two classes, and do not stress in this Court any possible respects in which this class of collateral may differ from the others.

XI.

None of the cases cited by the Petitioners establishes anything contrary to the conclusions expressed above.

The Reconstruction Finance Corporation and the Banks cite various cases which they apparently conceive to establish principles contrary to the conclusions expressed above, but we do not so read the cases they cite (Reconstruction Finance Corporation Brief, at pp. 33-34, 38-44; Bank's Brief, pp. 17-21).

It is significant that the Petitioners nowhere expressly contend that if a creditor in a bankruptcy holds a mortgage bond issued by the bankrupt as security for its debt, and purports to transfer the mortgage bond after the commencement of the bankruptcy proceeding, the transferee may prove a deficiency claim based on the face amount of the mortgage bond so transferred. Not a single case is referred to as establishing that such would be the effect of a transfer after the commencement of the bankruptcy proceeding. Yet it seems rather futile to determine whether such "collateral" may be sold unless it is determined what the effect of a sale will be.

Furthermore, with one possible exception, not a single case cited by the Petitioners indicates that the Bankruptcy

Court may not control attempted transfers of pledged mortgage bonds of a bankrupt, and in that case it is impossible to determine just what the Court did hold.

The principal case relied upon is *Jerome* v. *McCarter*, 94 U. S. 734. In reading the references to it in the two Briefs one might suppose that it was a bankruptcy case. It was not. It was an equity case. It came to this Court on an appeal from a decree in a foreclosure action. The only question presented was as to the right of certain transferees of mortgage bonds to share in the proceeds of the sale on foreclosure. Those transferees had acquired the bonds by purchase from other creditors of the company during the pendency of a bankruptcy proceeding, *an entirely separate proceeding.* No question was presented, as here, with regard to the power of a bankruptcy court to bar or control an attempt by a secured creditor to make a partial assignment of its security when such security consists of a fractional interest in property in the bankrupt estate. Presumably the Court in the bankruptcy proceeding referred to in the opinion in *Jerome* v. *McCarter* had not been asked to control any transfer of the bonds. As a matter of fact almost nothing appears in the opinion about the bankruptcy proceeding. Certainly the question now before this Court was not even remotely considered.

A simple analogy will show what was decided in *Jerome* v. *McCarter*. Let us assume that, after the commencement of this bankruptcy proceeding but before the order under review was entered, the Chase National Bank had transferred the pledged First and Refunding Bonds to the First National Bank of the City of New York. Let us further assume that it proved to be impossible to have a reorganization plan in this proceeding and that it was therefore dismissed, but that an equity foreclosure action was there-

after commenced by the Trustees of the First and Refunding Mortgage. Let us assume further, that at the time of the sale in the equity foreclosure the First National Bank asserted the right to share ratably in the proceeds of the foreclosure sale, and that there were no other assets of the Railway Company except those subject to the First and Refunding Mortgage. If such a situation had arisen, and if the contention had been made at that juncture by holders of the outstanding First and Refunding Bonds that the First National Bank was not entitled to share in the proceeds of the foreclosure sale, *Jerome* v. *McCarter* would be controlling. For it held that the mere fact of the pendency of a bankruptcy proceeding did not prevent a transfer of pledged mortgage bonds from being effective *to the extent of entitling the transferee to share in the proceeds of a subsequent equity foreclosure.*

Guaranty Trust Co. of New York v. *Galveston City R. Co.*, 87 Fed. 813, was also not a bankruptcy case, but an *equity* case. The Guaranty Trust Co., as Trustee of an issue of bonds of the Galveston City Railroad Co., commenced a foreclosure action. It so happened that in its capacity as a bank it had made a loan to the Galveston City Railroad Co., secured by bonds of another issue of which the United States Mortgage & Trust Co. was trustee. The Galveston City Railroad Co. sought to restrain the Guaranty Trust Co., acting in its individual capacity, from selling the second mortgage bonds held by it as collateral. As it was a *receivership* case, the Court said that it was not concerned with the loan at all. Its ruling was as follows (p. 815, italics ours):

> "The foreclosure was commenced and prosecuted by the bondholders through their representative. That controversy is wholly between the bondholders and the railroad company, and *the controversy be-*

> *tween the railroad company and the appellant respecting this $50,000 loan is altogether foreign to the foreclosure proceedings.* The bondholders are in no wise concerned in it, and their foreclosure proceedings cannot properly be modified or incumbered thereby."

In re Ironclad Mfg. Co., 192 Fed. 318, is the one case which seems to be somewhat in point on the facts, but it nowhere determines the effect of a transfer, after the commencement of bankruptcy proceedings, of mortgage bonds held by a creditor as security. The report shows merely that an application was made for an injunction, which was denied with an opinion of one sentence written by District Judge VEEDER and reading as follows:

> "After careful consideration I have reached the conclusion that the motion must be denied on the authority of Jerome v. McCarter, 94 U. S. 734, 24 L. Ed. 136."

Judge VEEDER's decision was affirmed by the Circuit Court of Appeals on his opinion. The Court did not say what the *effect* of a sale of the collateral would be. It did not even say *why* it allowed the sale. For all that appears the property secured by the mortgage bonds was not in the possession of the Bankruptcy Court at all; the Bankruptcy Court may have permitted a foreclosure in the State Court after the commencement of the bankruptcy proceeding, or a foreclosure may have been commenced prior to the bankruptcy, which the Court had no power to enjoin. Cf. *Straton* v. *New*, 283 U. S. 318. If such was the case, there was no reason why the bonds held as collateral should not be sold and the purchasers allowed to prove their respective interests in the proceeds of the foreclosure sale; the Bankruptcy Court was not concerned with that. The Court did *not* hold that a purchaser of the bonds would obtain a claim provable in

bankruptcy or any other rights enforceable in the bankruptcy proceeding. Apparently the question was not considered.

In *Turner* v. *Metropolitan Trust Co.*, 207 Fed. 495, the fact is that the *sale of the pledged bonds preceded the bankruptcy.* The sale took place on August 30, 1911. The corporation was adjudged bankrupt on October 26, 1911.

The Brief of Reconstruction Finance Corporation argues, somewhat disingenuously we think, that "No point was made in the case that the pledged bonds were sold prior to the filing of the petition in bankruptcy" (p. 42). The argument seems to us somewhat disingenuous because our theory as to the rights of the pledgees depends partly upon what we conceive to be the effect of the commencement of the bankruptcy proceeding and the difference between a sale before and an attempted transfer after the commencement of such a proceeding. The petitioners, citing *John Matthews, Inc.* v. *Knickerbocker Trust Co.*, 192 Fed. 557, acknowledge that there is a difference between a sale before and an attempted transfer after bankruptcy in the case of unsecured bonds (R. F. C. Brief, pp. 34, 44-46; Bankers' Brief, p. 18). We contend that it makes the same difference in the case of pledged mortgage bonds of a bankrupt whether the sale takes place before or an attempt is made to sell after the bankruptcy.

All that the *Turner* case decided was that a pledgee of mortgage bonds issued by the pledgor could buy in at a sale taking place before the bankruptcy and could prove for the face of the bonds so bought in. And if a borrower can pledge a bond to secure a debt of a smaller amount and enable the pledgee to create a new debt by transferring the pledged bond before the bankruptcy, there seems no reason why the pledgee itself should not be able to become the owner

of the new debt; a contrary rule would simply exclude one of the bidders when a pledged bond was offered for sale.

The case of *Rogers Brown & Co.* v. *Tindel Morris Co.*, 271 Fed. 475, was an equity case and is therefore not in point.

The only cases cited by the banks on the question really involved here are *Jerome* v. *McCarter, In re Ironclad Mfg. Co.*, and *Turner* v. *Metropolitan Trust Co.*, all of which have been discussed above (Banks' Brief, p. 19).

XII.

The Petitioners were not entitled to interest on their claims after the bankruptcy proceeding commenced.

The question of the propriety of paying interest on the Petitioners' claims is not directly involved in this Court, but it is important to the General Mortgage Bondholders that the record with regard thereto be clear.

We take it that there is no doubt that after the bankruptcy proceeding commenced the Petitioners had no right to any payment of interest out of the estate of the Principal Debtor, as distinguished from their right to income from the pledged collateral. Such income they have received (R. 341-342).

Nevertheless, on June 26, 1933 an order was made directing the payment of interest to the Reconstruction Finance Corporation (R. 11-18). On August 1, 1933, a second order was entered under which interest was paid both to the Reconstruction Finance Corporation and the Banks (R. 19-22). The first of these orders was made before the formation of the General Mortgage Committee and the second was

entered without notice to it (R. 34). On August 28, 1933 a third order was entered, of which the Reconstruction Finance Corporation was the beneficiary (R. 28-36). This order was entered over the objection of the General Mortgage Committee (R. 32-35).

When the Principal Debtor filed its petition of September 28, 1933, on which the order under review was entered, the General Mortgage Committee again objected to any interest payments (R. 59-63). One of the grounds for its objection was that the payment of the interest would require a diversion of the earnings of the General Mortgage and of the other mortgages (R. 61). The Court, in order to obtain time to decide whether to grant the injunction prayed for, directed the payment of interest to the Reconstruction Finance Corporation on the undertaking of the Petitioners that they would not "convert, sell or dispose of the collateral pledged under their various notes, respectively, except upon five (5) days' notice to the Debtor Corporation, *if the interest due September 30, 1933 on the said Reconstruction Finance Corporation loan should be paid*" (R. 77, italics ours).

The record does not admit of any doubt that the various payments of interest were made in order to induce the Petitioners not to transfer their collateral (see also R. 14, 20, 29). Following the entry of the order under review no further interest payments were made out of the estate, but the Petitioners received the income from the pledged collateral (R. 341-342).

The Petitioners contend that the Circuit Court of Appeals misunderstood the facts, when it said in its opinion (R. 325):

> "Appellants have received and will probably continue to receive the prompt payment of interest upon their claims secured by the debtor's and its subsidiaries' bonds."

Whether there was any misunderstanding or not, we cannot believe that the opinion was intended to convey the impression that the Petitioners were entitled to interest, even if not earned on the collateral, for clearly they were not as a matter of law.

The interest on the General Mortgage is not now being paid (Cf. Appendix to R. F. C. Brief, p. 165), and it is obvious that further payments of interest to the Petitioners would require diversion of the earnings of the General Mortgage as well as a depletion of cash urgently needed for other purposes (*id.*, pp. 161-166).

We state the facts with regard to the pledgees' demands for interest principally in order that an accurate record will be readily available to the Court. The matter of the interest, it seems to us, has no direct bearing on the power of the District Court to enter the order under review, and, except to the extent indicated above at pages 38-40, no bearing on the propriety of the exercise of that power.

CONCLUSION.

The order below should be affirmed.

Respectfully submitted,

JAMES H. MCINTOSH,
CLIFTON P. WILLIAMSON,
EDWARD W. BOURNE,
Attorneys for Respondent,
Protective Committee for The Chicago, Rock Island & Pacific Railway Company General Mortgage Bonds.

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